reflect an appropriate balancing of "the investor and the consumer interests",[43] and will yield confiscatory rates for any number of cable systems in violation of the Fifth Amendment to the United States Constitution.

The Constitution requires that the Commission's rate orders effectuate results which are "just and reasonable" to both consumers and investors.[44] In order to achieve this result, the Commission must give due consideration to the impact its orders will have on the legitimate interests of cable industry investors.[45] More specifically, the Commission must take into account how its order will affect

> the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock . . . . [T]he return to the equity owner should be . . . sufficient to assure confidence in the financial integrity of the enterprise so as to maintain its credit and to attract capital.[46]

The constitutional limits on the Commission's regulatory authority are designed to ensure that it does not issue rate

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[43] Hope, 320 U.S. at 603.

[44] See, e.g., Hope, 320 U.S. at 603; Duquesne Light Co. v. Barasch, 488 U.S. 299, 310-12 (1989); Permian Basin Area Rate Cases, 390 U.S. 747, 767 (1968); Jersey Cent. Power & Light Co. v. FERC, 810 F.2d 1168, 1172 (D.C. Cir. 1987).

[45] Hope, 320 U.S. at 603; Jersey Cent. Power & Light, 810 F.2d at 1172 ("It is axiomatic that the end result of Commission rate orders must be 'just and reasonable' to both consumers and investors, and that, in achieving this balance, the Commission must consider the impact of its rate orders on the financial integrity of the utility.").

[46] Hope, 320 U.S. at 603.

orders which impair a company's "access to capital markets, the ability to pay dividends, and general financial integrity."[47] As the Supreme Court has noted, "The Constitution protects the utility from the net effect of the rate order on its property."[48]

The Commission already has recognized that cost of service rules are needed because its benchmarks will fail to provide adequate revenue flows for a substantial number of cable operators. Application of the benchmarks to these operators could seriously undermine the financial stability of their systems. Thus, the development of a cost of service proceeding is not only a prudent policy decision; it is a constitutional necessity for ensuring the validity of the benchmark rules. But the Commission's tentative proposal to automatically exclude a substantial portion of cable's invested capital (in the form of excess acquisition costs) from the ratebase will severely harm operators' access to capital, ability to earn a reasonable return, and general financial integrity. Adoption of the proposal in the face of such dire financial consequences would represent a complete disregard of the legitimate investor interest and yield results which are both unjust and

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[47] Jersey Cent. Power & Light, 810 F.2d at 1180. See also Duquesne Light, 488 U.S. at 312 (Constitutional concerns implicated if rate orders "jeopardize the financial integrity of the companies, either by leaving them insufficient operating capital or by impeding their ability to raise future capital . . . ,[or] are inadequate to compensate current equity holders for the risk associated with their investments . . .").

[48] Duquesne Light, 488 U.S. at 314.

unreasonable.[49] Because the Commission's tentative proposal cannot withstand a constitutional challenge and is inequitable, it must be abandoned.[50]

Perhaps the most glaring constitutional defect of the Commission's tentative proposal is that it would deny a cable operator any opportunity to ever justify the inclusion of so-called "excess" acquisition costs in its ratebase. In Jersey Central Power & Light, the D.C. Circuit ruled that FERC had failed to comply with Hope when it summarily refused to give a regulated entity the opportunity to demonstrate that the exclusion of unamortized depreciation expenses for an abandoned nuclear power plant would damage its financial integrity and

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[49] While the Commission places great reliance on the alleged discretion conferred upon a regulatory agency by the Supreme Court in Hope, "[a]ll that was held [in Hope] was that a company could not complain if the return which was allowed made it possible for the company to operate successfully." Market St. Ry. Co. v. Railroad of California, 324 U.S. 548, 566 (1945). The converse is equally true: a company does have a cognizable constitutional complaint if the rate order prevents it from operating successfully. The cost-of-service rules proposed by the Commission will yield this result unless the Commission abandons its tentative conclusion with respect to "excess" acquisition costs.

[50] The constitutional vulnerability of the Commission's tentative proposal is exacerbated by the lack of substantial evidence for the notion that excess acquisition costs automatically constitute an expectation of monopoly earnings. See e.g., Permian Basin Area Rates Cases, 390 U.S. at 792 ("each of the order's essential elements is supported by substantial evidence); Washington Gas Light Co. v. Baker, 188 F.2d 11, 15 (D.C. Cir. 1950), cert. denied, 340 U.S. 952 (1951)("Despite the broad limits allowed the Commission, it remains imperative that its findings, under whatever formula adopted, be based upon substantial evidence in the record.").

impair its access to capital.[51] The so-called "excess" acquisition costs constitute a substantial portion of cable's invested capital. Rate orders issued by the Commission under its cost of service rules cannot possibly be construed as having given due consideration to the legitimate interests of investors, if the Commission's rules never even give operators the chance to demonstrate the validity and necessity of including all -- or even a portion -- of these costs in the ratebase.[52]

D. THE COMMISSION SHOULD PERMIT CABLE OPERATORS TO INCLUDE IN THE RATEBASE ALL LEGITIMATE CAPITAL COSTS INCURRED FOR THE CONSTRUCTION, EXPANSION, AND ACQUISITION OF THEIR SYSTEMS

The Commission must take a system-specific approach to the issue of ratebase valuation, or it will defeat the statutory goal of encouraging continued investment by cable operators. Cable operators must have the opportunity to present to the Commission all legitimate capital costs incurred for the construction, expansion, and acquisition of their systems, in order to justify rates which exceed the benchmarks.

1. THE COMMISSION SHOULD PERMIT OPERATORS TO INCLUDE IN THE RATEBASE ALL ACQUISITION COSTS INCURRED DURING DEREGULATION

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[51] See Jersey Cent. Power & Light, 810 F.2d at 1178, 1181.

[52] See Hope, 320 U.S. at 603. The Commission also has solicited comment on whether it should permit amortization of excess acquisition costs as an annual expense. Notice at ¶ 41. Such a proposal would still fail to pass constitutional muster because it would summarily deny operators any opportunity to show that such costs properly belong in the ratebase. See Jersey Cent. Power & Light, 810 F.2d at 1178, 1181.

A presumption of legitimacy should be attached to cable system transactions which occurred in a free market environment. If the Commission feels compelled to disallow so-called excess acquisition costs, it should do so solely on a going-forward basis. During this regulatory transition,[53] cable operators should have the opportunity to include in the ratebase the full price of any acquisition which took place during deregulation that was the result of an arms-length transaction.

It is both unjust and unreasonable for the Commission to, in effect, retroactively condemn a substantial portion of the cable industry's invested capital, particularly when that capital was generated in a deregulatory environment sanctioned by Congress. Nothing in the Cable Act requires the Commission to recalculate in a post-hoc manner system transactions which took place in a competitive marketplace, and there are sound policy reasons for the Commission to stay its hand. Accordingly, the Commission's cost of service rules should simply presume the validity of all acquisition costs incurred prior to enactment of the Act.

2. AT A MINIMUM, THE COMMISSION MUST ALLOW OPERATORS AN OPPORTUNITY TO DEMONSTRATE THE LEGITIMACY OF ACQUISITION PREMIUMS

A rule which bars operators from having any opportunity to demonstrate the legitimacy of acquisition premiums will not pass constitutional muster. Such a rule completely disregards the

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[53] The Commission itself notes that "an equitable balancing of consumer and cable operators interests may require an allowance in ratebase of some excess acquisition costs in view of the transition of the industry from a nonregulated to a regulated environment." Notice at ¶ 39.

legitimate interests of investors and constitutes a summary refusal by the Commission to allow cable operators who face deep financial hardship a chance to justify the inclusion within the ratebase of a substantial portion of its invested capital.[54/]

There is no evidentiary foundation -- and thus no constitutional basis[55/] -- for adopting a blanket rule that disallows the recovery of all excess acquisition costs based on the assumption that such costs automatically represent monopoly rents. Accordingly, the Commission must at least give cable operators an individualized opportunity to demonstrate the legitimacy of acquisition costs which exceed the book value of the plant in service.[56/]

3. THE COMMISSION SHOULD ADOPT A PRAGMATIC APPROACH TO VALUATING CABLE'S PLANT IN SERVICE, RATHER THAN FORMULAIC ONE

In the Notice, the Commission evaluated various possible cost methodologies before tentatively proposing to value cable's plant in service using original cost, which it defines as "the initial construction cost of the property, adjusted for all subsequent capital transactions including depreciation,

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[54/] Jersey Cent. Power & Light, 810 F.2d at 1178, 1181.

[55/] See Section II.C, supra.

[56/] Cf. Amendment of Part 65 of the Commission's Rules to Prescribe Components of the Rate Base and Net Income of Dominant Carriers, Order on Reconsideration, 4 FCC Rcd 1697, 1704 (1989) (permitting Title II carriers to justify inclusion of "excess" amounts in the ratebase on a case-by-case basis), remanded in part, Illinois Bell Telephone Co. v. FCC, 911 F.2d 776 (D.C. Cir. 1990), on remand, 7 FCC Rcd 296 (1991), aff'd, 988 F.2d 1254 (D.C. Cir. 1993).

retirements, and improvements."[57] The Commission recognized that this approach may be difficult to apply "where adequate accounting records have not been kept."[58] It also recognized that other cost methodologies might be more effective in stimulating new investment and encouraging infrastructure upgrades.[59]

In addressing this issue, the Commission should bear in mind that the goals of cost of service are to permit operators to justify rates which exceed the benchmarks and to encourage new investment. The aim of cost of service regulation of the cable industry is not to obtain some predetermined formulaic fit between rates and costs.[60] Instead, the purpose is to allow operators who have valid and economically justified reasons for charging rates higher than the benchmarks to seek approval for those rates from regulators.

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[57] Notice at ¶¶ 35, 33 n.36.

[58] Id. at ¶ 33 n.36.

[59] Id. at ¶ 33 n.37.

[60] If that were the principal goal, then the tentative proposals adopted by the Commission would yield some rather anomalous -- and perhaps even arbitrary -- results. For example, the cost of constructing a new-build state-of-the-art facility in a high-density urban area might justify basic rates well in excess of $50.00 per month. Obviously, it may not be possible for an operator to charge such rates, since they would frustrate the goal of maximizing penetration levels. On the other hand, the Commission's tentative proposals regarding excess acquisition costs and plant in service valuation would probably prevent an operator of a recently acquired middle-aged system to justify rates which exceed the benchmarks. Accordingly, that operator would probably be unlikely to have sufficient funds to upgrade that system or offer new services to subscribers.

Thus, the Commission should approach the cost methodology issue in a pragmatic, rather than a formulaic, manner. The Commission should avoid adopting a rigid and mechanical cost formula to which all operators must adhere before even having an opportunity to avail themselves of the cost of service proceeding, particularly since that methodology may differ from the approach used by operators prior to passage of the Act. Rather, the Commission should strive to be as flexible as possible with respect to the cost methodologies which it uses for valuing the ratebase. Since the goal is to determine whether the operator has valid reasons for charging rates which exceed the benchmark, the Commission should focus first on the particular cost elements presented by the operator and then on the methodology by which those elements are presented.[61/]

If the Commission wishes to adopt a particular industry-wide cost formula, the most pragmatic approach would be to utilize an original cost standard which accepts the cost on the books as reported under GAAP at the point in which the plant is first dedicated to public service -- e.g., September 1, 1993, the effective date of the Commission's rate regulation rules. All plant constructed or acquired after the date of initial regulation would be valued at original cost. Plant acquired

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[61/] The Commission should adopt a similarly pragmatic approach with respect to the issue of allocating costs between tiers. See Section IV.B, infra.

would be valued for ratemaking purposes based on the sellers carrying value.[62]

4. THE COMMISSION SHOULD ALLOW OPERATORS TO INCLUDE WITHIN RATEBASE NET OPERATING LOSSES

The cost of service rules should not punish cable operators who incurred large start-up losses and accumulated significant debt in order to invest in their infrastructure and programming. The deferral of cost recovery and capital returns by cable investors has yielded tremendous benefits for subscribers by giving operators the leeway they needed to make a broad range of cable programming service available to nearly every household in a remarkably short period of time.[63] It would seriously damage the prospects for future cable investment -- and thereby harm both operators and consumers -- if those who helped cable through its infancy were denied the returns they expected upon the realization of its growth. Accordingly, the Commission should

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[62] An original cost valuation based on the effective date of regulation would be a relatively simple approach to apply because cable operators and regulators could base plant valuations on accounting records. This approach would also streamline the process and alleviate the arguments surrounding fair value or market valuation approaches such as replacement cost, reproduction cost, or a combination of both, as well as mitigate external reporting problems which could arise from different methodologies.

[63] For instance, as explained above, while the cost of constructing a new-build state-of-the-art facility in a high-density urban area might justify basic rates well in excess of $50.00 per month, cable operators generally do not charge such rates. In order to increase subscriber penetration, investors have been willing to postpone a return of and on their investment until a system matures. See Section I.A, supra.

permit cable operators to include within the ratebase the unrecovered portion of accumulated net operating losses.

III. THE RATE OF RETURN PROPOSED BY THE COMMISSION FAILS TO REFLECT CABLE'S UNIQUE MARKET RISKS

The Commission has proposed to establish a single rate-of-return which would apply to all cable operators who seek to have their rates set through the cost-of-service proceeding.[64/] The Commission has tentatively concluded that a rate of return in the range of 10-14 percent "would reflect a reasonable balancing of subscriber and cable interests."

The Commission is obligated to establish a rate of return which provides investors with fair compensation for the risks which they have assumed and ensures continued confidence in the regulated company's financial integrity and ability to attract capital.[65/] The Supreme Court has noted that the risks faced by traditional utilities are largely defined by the rate methodology employed by regulators because "utilities are virtually always public monopolies dealing in an essential service, and so relatively immune to the usual market risks."[66/] But that analysis is inapplicable to cable, because cable is neither an essential service nor immune to market risks. As an industry, cable faces far greater risks than traditional utilities. In addition, investors in cable systems, unlike in traditional

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[64/] Notice at ¶ 46.

[65/] Hope, 320 U.S. at 603.

[66/] Duquesne Light, 488 U.S. at 315.

utilities, reinvest their dividends in the continued upgrade and expansion of the systems; cable investors rely on stock appreciation to realize long-term profits through capital gains. Within the cable industry, moreover, risks vary from operator to operator because of the different combinations of regulatory and competitive conditions in each franchising area.

The Commission's reliance on the S&P 400 index and its experience with telephone regulation is misplaced. In setting a rate of return, the Commission is required to pay closer attention to the specific set of risks and expectations faced by cable investors.[67] The S&P 400 index simply does not embody the unique and hybrid risks which cable investors encounter,[68] while the use of the telephone industry as a possible surrogate for cable is particularly inappropriate. The Commission's tentative proposal to set the rate of return via a surrogate, rather than

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[67] Cf. Id. at 314 ("the impact of certain rates can only be evaluated in the context of the system under which they are imposed").

[68] For example, few industries face the risk of both price regulation and the prospect of vigorous future competition; fewer still are required by law to assist in the growth of their competitors. See 47 U.S.C. § 548. In addition, cable investors are unusual in that they postpone returns to capital over a longer period of time based upon the expectation of an adequate aggregate yield over the life cycle of their investment. These factors, and others, must be taken into account by the FCC in setting the rate of return.

The S&P 400 index is a particularly inappropriate tool to measure the rate of return of cable partnerships. Partnerships have a significantly increased risk factor than do Subchapter C Corporations, and, generally, partners expect a higher rate of return for this risk. The Commission should permit partnerships this higher rate of return, especially in view of its proposal to disallow recovery of partnership taxes. See Section IV.C, supra.

through an industry-specific or company-specific inquiry, raises the prospect that some operators will be unable to obtain a fair and equitable return on their costs.[69] It may be appropriate and administratively efficient for the FCC to adopt a return range which is presumptively reasonable for the purpose of cost-of-service, but operators still should be permitted to seek a higher return based upon the specifics of their situation.[70]

IV. MISCELLANEOUS ISSUES

Recognizing that its cost of service rules could have a significant impact on the financial practices and structure of

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[69] Significant constitutional questions would be raised if the rate of return set by the Commission yields revenues too low to make it "possible for [companies] to operate successfully." Market St. Ry., 324 U.S. at 566. See Section II.C, supra.

[70] The FCC may even wish to limit the circumstances under which an operator can seek to deviate from the range which it adopts. At a minimum, however, it is critical that operators be allowed to deviate from the range if that is necessary to recover the financing costs of the system under consideration. For example, when financing instruments are tied to specific levels of performance (e.g. loan covenants which require the maintenance of certain cash-flow to debt ratios), the Commission's rules should be sufficiently flexible to permit operators the opportunity to justify a higher return based upon those special circumstances.

The Commission also should consider allowing companies to use the cash flow method to determine its rate of return to the extent the operator can demonstrate the cash flow is the critical measure of its financial costs and is the best surrogate for its financing costs. Debt covenants which measure financial performance as well as all ratios measuring operating performance are based on cash flows. The FCC also should consider allowing the use of cash flow to support the unique circumstances of smaller operators or operators with significant cash needs. For example, assume that an operator has very little invested capital but needs to rebuild its infrastructure. Restricting the company to a return on this small investment could prevent the operator from securing the necessary financing to rebuild its plant.

the cable industry, the Commission has suggested that certain transition mechanisms may be necessary to enable cable operators to adapt to a rate regulated environment.[71] As part of this transition, Cablevision respectfully suggests that such issues as depreciation, accounting and cost allocation standards, and the selection of test year methodology be addressed on a case-by-case basis or by convening industry working groups rather than through the adoption of generic requirements. Consistent with the legislative recognition of the unique financial structure of the cable industry, the Commission's treatment of taxes should be modified and its proposal to adopt a productivity offset should be postponed.

A. DEPRECIATION PRACTICES

Cablevision rejects the Commission's tentative proposal to prescribe depreciation rates and methodologies for purposes of developing cost-based rates.[72] Instead, the Commission should adopt its alternative proposal to monitor operator depreciation practices. As the Commission recognizes, a monitoring approach would reduce administrative burdens on the Commission and on cable operators.[73] Moreover, such an approach would not increase the risks of higher rates for cable subscribers, since cost of service showings are simply a secondary or "backstop"

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[71] Notice at ¶ 22.

[72] See Notice at ¶27.

[73] See Notice at ¶ 29.

method of regulating rates.[74] Cablevision would be willing to explain and justify its depreciation practices in cost of service showings,[75] or to report on such practices in compliance with the Commission's information collection rules.

It is essential that operators be permitted to use and justify on a case-by-case basis their company-specific depreciation rates, as reported in SEC financial statements. Depreciation expense varies from company-to-company.[76] It has a tremendous impact on subscriber rates under rate regulation, and on the availability of funds that can be used to increase penetration and upgrade infrastructure. Prescription of an industry-wide rate or band of reasonable rates, or of individual rates for each plant category, would not adequately account for the distinct characteristics of each cable system.[77]

B. ACCOUNTING AND COST ALLOCATION

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[74] See Notice at ¶ 15 n.16.

[75] See Exhibit 8 (summarizing Cablevision's depreciation and amortization practices).

[76] See Notice at ¶ 26 (noting that "current depreciation practices may vary widely across the country. Thus, depreciation requirements could have a significant impact on the industry").

[77] If depreciation rates are nevertheless prescribed, they must permit recovery of the asset over its useful life, without regard to the valuation method ultimately used to determine the value of plant to be included in the ratebase. Moreover, the Commission should not prescribe one method of valuation for including plant in the ratebase and a different valuation method for calculating depreciation expense and accumulated reserve. The use of different methods would impose a tremendous burden on cable operators, contrary to the statutory directive. See 47 U.S.C. § 543(b)(2)(A).

Consistent with congressional intent that cable rate regulation not replicate Title II regulation[78] and that the Commission's rules minimize the burden imposed on cable operators,[79] the Commission must not subject cable to the equivalent of the detailed system of accounting applicable to common carriers under the Part 32 Uniform System of Accounts (USOA). Rather, recognizing the need for uniformity, Cablevision proposes that the Commission permit an industry working group to develop a cable-specific uniform system of accounts which will facilitate review of cost of service showings without unnecessarily burdening cable operators.

Cablevision opposes the Commission's tier-neutral approach of allocating costs between tiers proportional to the number of channels on the tier.[80] All costs simply are not incurred in a "tier neutral" manner. Certain costs, such as equipment and installations, are not incurred on a per channel basis. Plant costs (engineering, filed service and repair, and warehousing), which remain fixed, could be allocated on a per channel basis once all costs associated with equipment and installations have been properly allocated. Customer operations (telephone

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[78] House Report at 83.

[79] See 47 U.S.C. § 543(b)(2)(A).

[80] See Notice at ¶¶ 11, 59. While the Commission has adopted a "tier-neutral" structure for its benchmark regulations, an operator making a cost-of-service showing should be able to separately identify tier-specific costs in justifying the rates for various regulated tiers of service.

operations, service centers) vary based on the number of subscribers or franchise requirements.

Because costs are not incurred in a "tier neutral" manner, any attempt to allocate them under such a scheme could result in a subsidy of basic and expanded basic rates. Cablevision proposes that the Commission permit systems to support their allocation methods on a case-by-case basis.[81/]

C. TAXES

Cablevision strongly supports the Commission's proposal to allow taxes associated with regulated cable services, including all local, state and federal taxes on the provision of cable service and income taxes attributable to the provision of regulated cable service, to be included in determining an operator's annual expenses.[82/] "Income" taxes should be clarified to include Federal, state and local income taxes, both current and deferred.[83/] Further, income taxes should be

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[81/] Cablevision supports the Commission's proposal to permit some categories of external costs to be aggregated or averaged at the company level and then allocated to the franchise level and tier in accordance with the Commission's cost accounting requirements. See Notice at ¶ 86.

[82/] See Notice at ¶ 30.

[83/] Existing deferred taxes should not be deducted from rate base because subscribers have not paid rates based on a provision for deferred income taxes. In the future, if the Commission allows recovery of deferred taxes as a cost of service component and includes both current and deferred income taxes in rates, then the resulting deferred taxes could be deducted from the ratebase on a going-forward basis.

calculated on a "stand-alone basis" using the applicable statutory rates.[84/]

The recovery of income taxes attributable to the provision of cable service should not be limited to Subchapter C corporations, however, as the Commission proposes.[85/] It is simply unfair to deny investors in partnerships the recovery of their taxes, based solely on the form of legal ownership. Certain Cablevision partnerships are wholly-owned[86/] and 100 percent of the earnings of the partnerships are taxable at the corporate rate. To prohibit recovery of these taxes would penalize those partnerships and Cablevision as a whole.

In those instances where Cablevision investors chose a partnership form of ownership, they did so for legitimate business reasons. For instance, many of the company's partnerships were established at a time in the industry when stock offerings were not an option for equity capital or when the principles negotiated the partnership as part of the equity deal.

In many cases it would be difficult, if not impossible, to change the form of legal ownership from a partnership to a

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[84/] In other words, the taxes for each cable subsidiary should be calculated as if the subsidiary were not part of a consolidated group.

Cablevision notes that neither Appendix A nor Appendix B of the Notice provide for reporting or recording taxes. The Commission should ensure that its accounting and financial reporting requirements reflect the inclusion of taxes (either other or income) in operating expenses.

[85/] See Notice at ¶ 30 n.32.

[86/] See Exhibit 9 (chart showing Cablevision's structure).

Subchapter C corporation, in order to recover taxes. In view of the new rate regulated environment, Cablevision may not be able to raise the funds necessary to buy out the remaining partners and dissolve the partnerships. Further, some of the company's existing partnerships are wholly-owned acquired partnerships that are restricted principally by state regulations from changing the form of the business entity holding the franchise without re-application of the entire franchise agreement.[87]

Cablevision proposes that partnerships be allowed to recover income taxes either at the statutory Subchapter C corporation rate or at the average rate of the members of the partnership, whichever is lower. This will ensure that investors in partnerships are not penalized for the form of legal ownership they chose for their business entity.

D. EXPENSES

The Commission has correctly proposed certain costs as operating expenses that operators should be entitled to recover in rates for regulated cable service.[88] However, the Commission's list is incomplete. For example, it appears to exclude system power, security, and quality assurance.

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[87] See, e.g., Conn. Gen. Stat. §§ 16-43, -44, -47.

[88] See Notice at ¶ 24, Appendix A.

Cablevision would be willing to work with others in the industry to further refine the list of operating expenses.[89]

E. PRODUCTIVITY OFFSET

Cablevision believes that it is premature to consider a productivity offset feature in the price cap mechanism for cable operators.[90] As explained in detail above,[91] cable's basic infrastructure is still being built, and penetration remains at low to moderate levels. Given this industry structure, operators continue to have an incentive to keep overall costs at a low level and to maximize efficiency. Costs in many systems with lower than optimal penetration rates, such as newly-built urban systems, continue to outpace rates.[92] Adoption of a productivity offset at this time could penalize those systems that currently are operating efficiently.

F. TEST YEAR METHODOLOGY

The Commission should not adopt one test year methodology to be used in cost of service showings. Instead, cable operators should have the option of using any of the test year methodologies: historical test year; future test year; or a

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[89] Although Cablevision agrees with the concept of excluding recovery of operating expenses and other costs unrelated to the provision of regulated cable service, it believes that such unrelated expenses and costs should be identified and addressed on a case-by-case basis. See Notice at ¶ 23.

[90] See Notice at ¶¶ 81-85.

[91] See Section I.A, supra.

[92] See Exhibit 5.

combined historical and future test year. For the Commission to prescribe one methodology at this point, while it is still gathering information, would be premature. The test year methodology should be adopted only with full knowledge of the detailed workings of each system and a full assessment of incurred and anticipated costs.

If the Commission decides to adopt only one test year methodology, however, it should permit cable operators to use a future test year methodology. Rates are normally set on a prospective basis and based on test period data that are presumed to be representative of the prospective conditions when rates will be in effect. The future test year approach develops revenues and rates which are more reflective of the costs and investments of the rates period that rates will be in effect. It also permits rapidly growing start-up ventures to adequately reflect anticipated costs. For one of Cablevision's urban cable systems recently constructed, for instance, depreciation costs are increasing.[93/] If this system is unable to recover its anticipated high start-up costs, debt service could be jeopardized.

Whatever test year methodology is used, there is always some forecasting involved when developing rates for the future, either through pro formas for known and measurable changes to historical test year data or through the use of budgeted or fully forecasted test years. Cable operators should be permitted on a case-by-

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[93/] See Exhibit 5.

case basis to provide and support any adjustments necessary to develop representative test period data for the time period rates will be in effect.

G. PRESCRIBED FCC FORM

Cablevision supports the Commission's proposal to require that in any cost of service showing, costs and supporting data be presented on a prescribed form and associated worksheets.[94/] A cost of service filing package would reduce administrative burdens and provide for a uniform presentation of cost-based rates. Consistent with the Commission's streamlining objective, the filing package should request only data and information that is necessary under a cost of service showing to set rates. Cablevision recommends that the Commission permit the industry to provide assistance in developing the prescribed forms, worksheets and instructions.

[94/] See Notice at ¶ 19.

CONCLUSION

As proposed, the Commission's cost-of-service regulations would impose a financial straitjacket on the cable industry, and raise serious constitutional and equitable concerns. In particular, the broad characterization of all acquisition adjustments as "excess" would prevent cable investors from earning a reasonable return on their investments, and could make it difficult for cable companies to attract new capital at a time when they are facing increased competition in a dynamic marketplace. For these reasons, the Commission should revise its proposed cost-of-service rules as more fully set forth above.

Respectfully submitted,

CABLEVISION SYSTEMS CORPORATION

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August 25, 1993

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Index to Exhibits

1. Letters from lenders regarding the economic impact of regulations

2. Excerpts from Cablevision Systems Corporation, Form 10-Q as of June 30, 1993, and for the period then ended

3. Summary of Key Loan Covenants with exhibits

4. Excerpts from Cablevision Systems Corporation's 1992 Annual Report to Shareholders on Form 10-K

5. Chart of Actual Cablevision Systems Corporation system and recovery estimations

6. Chart showing ownership periods of major acquisitions

7. Application Form 100, as filed for A-R Cable Services, Inc. with the Commonwealth of Massachusetts and Extracts from the Exhibits to Application Form 100

8. Cablevision Systems Corporation Summary of Depreciation and Amortization Policies

9. Cablevision Systems Corporation, Entity Flowchart

EXHIBIT 1

Exhibit 1

June 21, 1993

Secretary
Federal Communications Commission
1919 M Street N.W.
Washington, D.C. 20554

Re: MM Docket 92-266
Report and Order and Further Notice of Proposed Rulemaking
In the Matter of Implementation of Sections of the Cable Television
Consumer Protection and Competition Act of 1992: Rate Regulation

Dear Sir:

Attached is a letter concerning the repercussions on the financial markets of the regulations adopted and proposed under the above referenced proceedings. The letter has been jointly endorsed by a number of the large commercial banks which follow and are active lenders to the cable television industry. We appreciate your consideration of the attached letter. If there are any questions please contact the undersigned.

Sincerely,

Douglas B. Smith
The Bank of New York
212-635-8471

Thomas E. Carter
NationsBank
214-508-0924